



MASSACHUSETTS SICPATRACE® OTP UPDATE

Presentation to: MA DOR – Illegal Tobacco
Task Force

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Date: November 2, 2017

Confidentiality level: **CONFIDENTIAL**



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Enabling trust

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AGENDA

- **Holistic approach to OTP Revenue Realization**
- **Expanding SICPATRACE® to OTP**
- **Benefits of tax indicia**
- **Federal Regulation**
- **Testing and optimizing**

HOLISTIC APPROACH TO OTP REVENUE REALIZATION

- “**Trust us**” strategy is no longer pertinent within this segment
- States need to have a clear strategy for Prevention & Response
 - Prevention reduces the likelihood of occurrence, assigns responsibility to key stakeholders and provide tools for response
- Stamping is a key component of the solution (Prevention) but stamping alone not enough to recover all lost revenue
- Agencies must engage multiple levels
 1. Better means for product identification (Stamping)
 2. Stricter Controls within the market place (Licensing and penalties)
 3. Provide tools for Response (Enforcement)

POTENTIAL REVENUE GAINS

- FY16 smokeless tobacco tax revenue of \$16.7M in MA
 - Per Task Force's 2017 annual report
- \$58M – \$78M range revenue estimate
 - Revenue range based on nationwide volumes and price figures published by the industry itself
 - Revenue estimate is based on shipments & smokeless use in MA and consumption model
 - CDC data for volume—data segmented by state and takes into account MA's low use of OTP
- SICPA still stands behind the computed \$41M – \$61M tax revenue gap

BENEFITS OF EXPANDING SICPATRACE® TO OTP

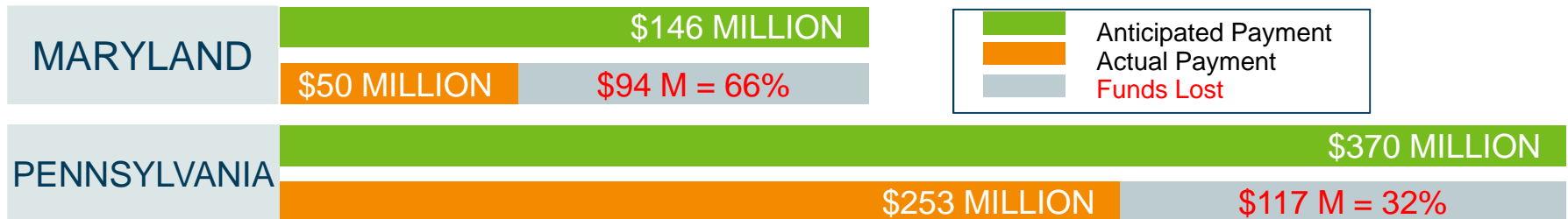
- Business case and the current loss of revenue for both the State and distributors justify the search for new measures
- Potential to increase market share for distributors that are licensed to sell to retail in MA while enhancing their ability to predict demand
- Integrated platform covering cigarettes and OTP
 - 1 reporting platform for DOR and other agencies (AG)
 - 1 inspection device/platform for DOR personnel
 - Based on existing system to minimize learning curve (for state users and stampers)
- SICPA taking a consultative approach with stakeholders on finding the most comprehensive, possible reparation of the costs

BENEFITS OF TAX INDICIA

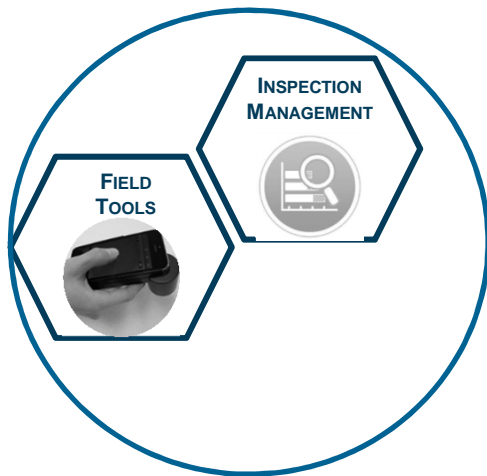
- 47 US states use tax indicia for tobacco
- Without tax indicia, inspectors have no way of deciphering legal product from illegal products or tax paid product from non-taxed products.
 - Stamping of cigarettes started in the early 1950s as a brand protection initiative by a major tobacco manufacturer. This initiative shaped the process States use to collect taxes as well as the way tobacco products (cigarettes) are packaged
- Holistic approach with emphasis on inspection imperative
- Success in California, a similar high tax environment also on SICPATRACE®
 - Multi-tiered approach to compliance (stamps, enforcement, licensing)
 - 900 million tobacco products traced annually
 - \$835 million in annual excise tax collections
 - Recovered \$91 million in annual tax revenues previously lost to illicit activity
 - 94 percent reduction in the number of counterfeits seized at inspections

DRIVING FORCE BEHIND MA DOR SICPATRACE SELECTION: MSA COMPLIANCE and REPORTING

- SICPA's solutions guarantee MSA compliance, protecting MA valuable revenue source
- Arbitration initiated by Participating Manufacturers (PM) based on NPM escrow terms of the MSA
 - Big four tobacco claimed 15 states were not diligently enforcing escrow requirements
 - MD, ME, NY and PA named from the Northeast Region
 - Rulings on Arbitration passed down September 2013 finding 6 states were not following the requirements including MD and PA
 - PA scheduled to lose \$242M (65%), reduced to \$117M by appeals judge



SICPATRACE® OTP ENFORCEMENT CAPABILITIES



- Field Auditing
 - Tools with ability to:
 - Identify illicit product
 - Validate genuine product
 - Validate licenses
- Inspection Management for OTP
 - Capture OTP field audit information
 - Field audit verification OTP

Federal Regulation and Compliance

- SICPA has developed a stamping solution to demonstrate ability to stamp MST products efficiently and effectively
- It is now up to the Task Force to evaluate and decide if State regulations need to be amended to allow stamping and tracking of MST products
- Task Force has the lead on working with FDA to understand the impact of stamping on their
- SICPA will work with Task Force to optimize OTP solution for FDA compliance
 - SICPA has communicated the ability to reduce the size of the stamp to comply with spacing requirements
 - SICPA

TESTING AND OPTIMIZING

- Extensive testing on various types of cans, including embossed lids, multi-can units and of various composition such as fiberboard and metal
- Developing equipment to handle multi-size products, regardless of their composition
- Proposed equipment capable of properly applying stamps on these units
- Looking for constructive ways to reach out for greater packaging uniformity
- Partnering with distributors to achieve most effective and cost efficient way to apply stamps

Next Steps

- SICPA and its partners will continue to support the taskforce and its objectives:
 - coordinate efforts to combat contraband tobacco distribution, including efforts to foster compliance with the law and conduct targeted investigations and enforcement actions against violators
 - modernize and strengthen the Commonwealth's laws pertaining to tobacco enforcement and compliance for all tobacco products sold in the Commonwealth
 - Investigate the legal and technical feasibility of stamping smokeless tobacco products complete its due diligence regarding OTP stamping and make recommendations to the Legislature.
 - Consider and plan cost allocation of the new machines and process



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Supporting Slides

SMOKELESS OTP ESTIMATES - Massachusetts

Factors		Source	
Massachusetts Demographics	Population	6,811,779	2016 US census
	Adult population %	79.80%	2016 US census
	Smokeless Tobacco Usage (% of total adult population)	1.33%	CDC, 2015
	Smokeless usage (people)	72,296	Computed
Smokeless Tobacco Sales	Smokeless US sales (K lb)	114,982	TMA report, 2015
	Part of Massachusetts	0.841%	Computed, assumption yearly consumption per person is homogenous among the various states
	Smokeless MA sales (K lb)	967	Computed
	Wholesale cost (\$/lb)	\$ 38.40	\$14.40 Ex factory pricing for a popular 5-cans sleeve
	MA Wholesale cost base (M \$)	\$ 37	Computed
Tax computation	MA Excise Tax (% wholesale price)	210%	www.tobaccofreekids.org factsheets
	MA Tax Revenue estimates (M\$)	\$ 78.00	Computed - Excise tax only, sales and other taxes not included
	MA Revenue (M\$)	\$ 16.70	DOR/Task Force, Fiscal year 2016
	Delta	\$ 61.30	Computed

SMOKELESS OTP ESTIMATES (low end) - Massachusetts

	Factors		Source
Massachusetts Demographics	Population	6,811,779	2016 US census
	Adult population %	79.80%	2016 US census
	Smokeless Tobacco Usage (% of total adult population)	1.10%	CDC, 2015
	Smokeless usage (people)	59,794	Computed
Smokeless Tobacco Sales	Smokeless US sales (K lb)	103,484	TMA report, 2015
	Part of Massachusetts	0.696%	Computed, assumption yearly consumption per person is homogenous among the various states
	Smokeless MA sales (K lb)	720	Computed
	Wholesale cost (\$/lb)	\$ 38.40	\$14.40 Ex factory pricing for a popular 5-cans sleeve
	MA Wholesale cost base (M \$)	\$ 28	Computed
Tax computation	MA Excise Tax (% wholesale price)	210%	www.tobaccofreekids.org factsheets
	MA Tax Revenue estimates (M\$)	\$ 58.06	Computed - Excise tax only, sales and other taxes not included
	MA Revenue (M\$)	\$ 16.70	DOR/Task Force, Fiscal year 2016
	Delta	\$ 41.36	Computed